[JOINT COMMITTEE PRINT]

EXPLANATION OF PROPOSED PROTOCOL TO THE INCOME TAX TREATY BETWEEN THE UNITED STATES AND BELGIUM

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

ON AUGUST 9, 1988

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OF THE

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INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, describes the proposed supplementary protocol to the income tax treaty between the United States and Belgium. The proposed protocol was signed on December 31, 1987, and was amplified by an exchange of notes signed the same day. The proposed protocol would amend the current U.S.-Belgium income tax treaty, which entered into force on October 13, 1972. A public hearing on the proposed protocol is scheduled on August 9, 1988, by the Senate Committee on Foreign Relations.

The primary reason for the negotiation of the proposed protocol was to reduce the tax at source on direct investment dividends from 15 percent to 5 percent, effective January 1, 1988. By thus reducing effective foreign tax rates, the proposed protocol will benefit many U.S. businesses that, particularly after the Tax Reform Act of 1986, have excess foreign tax credits on their foreign income.

In addition to reducing the direct investment dividend rate, the proposed protocol provides rules to prevent nonresidents of the United States and Belgium from enjoying the reduced rates of tax provided in the convention, as amended by the protocol (that is, the proposed protocol prevents a practice commonly referred to as treaty shopping).

The first part of the pamphlet is a summary of the principal provisions of the proposed protocol. The second part presents a discussion of the issues raised by the proposed protocol. This is followed by a third part containing a detailed, article-by-article explanation of the proposed protocol.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty between the United States and Belgium* (JCS–13–88), August 8, 1988.

I. SUMMARY

The proposed protocol contains the following modifications to the income tax treaty between the United States and Belgium.

(1) Dividends.—The proposed protocol would replace present Article 10 (Dividends) of the existing treaty with a new Article 10. The principal change is the reduction of the maximum allowable rate of tax at source on direct investment dividends. The existing treaty requires neither party to reduce its rate of tax at source on dividends below 15 percent. Under the proposed protocol, the maximum allowable rate would be reduced to 5 percent in cases where the beneficial owner of the payor is a company that owns at least 10 percent of the voting stock of the payor.

(2) Anti-treaty shopping provision.—The proposed protocol would add a provision to the treaty that generally ensures that the reduced rates of tax at source on dividends, interest, and royalties would be received only by corporations whose shares are publicly traded in Belgium or the United States and corporations controlled by any combination of U.S. residents, U.S. citizens, Belgium residents, or the countries themselves. The existing treaty does not contain an anti-treaty shopping provision. The proposed anti-treaty shopping provision is similar to those included in recently ratified treaties, but is somewhat less strict than the anti-treaty shopping provision of the 1981 proposed U.S. model income tax treaty (the "U.S. model treaty" or the "U.S. model").

II. ISSUES

The proposed protocol raises the following specific issues.

(I) Dividends paid by pass-through entities

The primary reason for the proposed protocol is to reduce the maximum allowable rate of tax at source of direct investment dividends. Under the existing treaty, this rate is 15 percent; the proposed protocol reduces that rate to 5 percent when the beneficial owner is a company that owns at least 10 percent of the voting stock of the payor.

These reductions from the Internal Revenue Code withholding rate of 30 percent are consistent with the U.S. model treaty and consistent with one objective of the U.S. income tax treaties—to eliminate international double taxation by an agreed division of income among two contracting parties. They reflect the view that where, for example, the United States already imposes corporate level tax on the earnings of a U.S. corporation, a 30 percent withholding rate may represent an excessive level of source country taxation. Moreover, the 5 percent rate reflects the view that the source country tax on payments of profits to a substantial nonresident corporate shareholder may properly be reduced further to avoid double corporate-level taxation and to facilitate international investment. However, even though the reductions will benefit many U.S. multinationals by reducing their effective foreign tax rates, the reductions raised a concern that when the dividends are paid by a U.S. company which generally does not pay any corporate level income tax they are inappropriate.

A regulated investment company (RIC) is a U.S. corporation that is subject to the regular corporate income tax, but that receives a reduction for dividends paid to its shareholders if certain conditions are met (Code secs. 852(b)(2)(D) and (3)). One of those conditions is the requirement that a RIC distribute most of its income. Thus, a RIC is treated, in effect, as a conduit for federal income tax purposes. One purpose of this entity is to allow investors to pool capital to diversify investments, which they might not be able to do otherwise, Dividends paid by a RIC generally are treated as U.S. source income, and thus, generally are subject to the U.S. withholding tax of 30 percent when paid to foreign shareholders.

Because a RIC generally does not pay any corporate level U.S. income tax on the earnings it distributes and because it represents for its investors a diversification of portfolio investments, the theory for reducing the maximum allowable rate of tax on U.S. source dividends in the case of dividends paid by a RIC to a "direct" investor is not present. Whether the investment in the RIC is above or below the threshold level for the direct investor dividend rate, the investment represents in effect an investment in the underlying portfolio investments of the RIC. Therefore, the

amount of stock owned in the RIC should be disregarded in determining whether the shareholder is a direct investor.

A real estate investment trust (REIT) is a corporation, trust, or association that is taxable as a U.S. corporation but that, like a RIC, receives conduit treatment for income that is distributed to shareholders if certain conditions are satisfied (Code sec. 857(b)). Like a RIC, a REIT must distribute most of its income to qualify for conduit treatment. A REIT is organized to allow persons to diversify ownership in primarily passive real estate investments. Often, the principal income of a REIT is rentals from real estate holdings.

Because a REIT is taxable as a U.S. corporation, a distribution of earnings is treated as a dividend, rather than income of the same type as the underlying earnings. This is true even though the REIT generally is not taxable at the entity level on the earnings it distributes. Because a REIT cannot be engaged in an active trade or business, its distributions are U.S. source and are thus subject to U.S. withholding tax of 30 percent when paid to foreign owners. When the distributions are composed of rental income, for example, they are not considered rental income to the recipient. Like dividends, U.S. source rental income of foreign persons generally is subject to U.S. withholding tax at a statutory rate of 30 percent (unless, in the case of rental income, the recipient elects to have it taxed in the United States on a net basis at the regular income tax rates). Unlike the tax on dividends, however, the withholding tax on rental income generally is not reduced in U.S. income tax treaties.

It has always been the United States' position to preserve the right to tax income from real property to the country in which the income is derived. Thus, the United States always preserves its right to tax real property income derived from the United States in its income tax treaties.

The issue presented under the proposed protocol and under the existing treaty is whether dividends paid by a RIC or a REIT should be treated differently from dividends paid by other U.S. corporations. Because those entities generally do not pay any corporate level U.S. income tax, and in the case of a REIT, because its income often is composed of a type of income over which the United States maintains its right to tax in its treaties, reducing the U.S. withholding tax rate on dividends as under the existing treaty and the proposed protocol is inconsistent with the purposes of the dividend rate reductions and maintenance of source country jurisdiction over real property income.

The committee could consider a reservation to the proposed protocol to modify the reduction of the U.S. withholding tax on dividends paid by a RIC and a REIT. It is understood that the Treasury Department considers the reductions in the proposed protocol and in the existing treaty to be inappropriate with respect to distributions from RICs and REITs. It is further understood that the Treasury Department will modify the reductions in the proposed protocol and in the existing treaty when a new treaty with Belgium is negotiated. Because the Treasury Department is pursuing expeditiously a new treaty with Belgium and expects to complete a new treaty within the next twelve months, and because a reservation

would considerably delay the benefits to be derived by U.S. multionationals under the proposed protocol, the committee could instead consider the proposed protocol with an understanding that the dividend reductions contained in the proposed protocol and in the existing treaty will be modified when the new treaty is negotiated.

(2) Treaty shopping

The proposed protocol, like a number of U.S. income tax treaties, generally limits source country withholding tax on dividends, interest, and royalties paid to residents of the other country. Although the proposed protocol is intended to benefit residents of Belgium and the United States only, residents of third countries sometimes attempt to use a treaty to obtain treaty benefits. This is known as treaty shopping. Investors from countries that do not have tax treaties with the United States, or from countries that have not agreed in their tax treaties with the United States to limit source country taxation to the same extent that it is limited in another treaty may attempt to secure a lower rate of U.S. tax by, for example, lending money to a U.S. person indirectly through a country whose treaty with the United States provides for a lower rate. The third-country investor may do this by establishing a subsidiary, trust, or other investing entity in that treaty country which then makes the loan to the U.S. person and claims the treaty reduction for the interest it receives.

The anti-treaty shopping provision of the proposed protocol differs form the anti-treaty shopping provision of the current U.S. model. While the U.S. model provision is only one of several approaches that the Treasury Department considers satisfactory to prevent treaty shopping abuses, the model provision is nonetheless a standard against which to compare the proposed protocol's anti-treaty shopping provision. The issue, then, is whether the proposed anti-treaty shopping provision effectively forestalls potential treaty shopping abuses.

One provision of the anti-treaty shopping article of the proposed protocol is more lenient than the comparable rule in the U.S. model and other U.S. treaties. The U.S. model allows benefits to be denied if 75 percent or less of a resident company's stock is held by individual residents of the country of residence, while the proposed protocol (like several newer treaties and an anti-treaty shopping provision in the Internal Revenue Code) lowers the qualifying percentage to 50, and broadens the class of qualifying shareholders to include residents of either treaty country (and citizens of the United States). Thus, this safe harbor is considerably easier to enter under the proposed protocol. On the other hand, counting for this purpose shareholders who are residents of either treaty country would not appear to invite the type of abuse at which the provision is aimed, since the targeted abuse is ownership by third-country residents attempting to obtain treaty benefits.

Another provision of the anti-treaty shopping article of the proposed protocol, which is coupled with the ownership requirement to achieve rate reduction benefits, is the "base erosion" rule. This requirement is met only if more than 50 percent of the gross income of the person claiming benefits is not used directly or indirectly to

meet liabilities for interest or royalties to persons who are not residents of Belgium or the United States, citizens of the United States, or the countries themselves. This rule, commonly referred to as the "base erosion" rule, is necessary to prevent a corporation, for example, from distributing most of its income through the use of deductible payments to persons not entitled to benefits under the treaty. Because the rule is limited to payments of interest or royalties to persons not entitled to benefits, the provision may not be broad enough to achieve its intended purpose. It is understood that the Treasury Department is continuing to examine the scope of the base erosion rule to ensure that its breadth is adequate. It may be that other forms of payments, such as management fees or compensation arrangements, will have to be included when the treaty is renegotiated.

Another provision of the anti-treaty shopping article differs from the comparable rule of the U.S. model, but the effect of the change is less clear. The general test applied by the U.S. model to deny benefits is a broad one, looking to whether the acquisition, maintenance, or operation of an entity had "as a principal purpose obtaining benefits under" the treaty. By contrast, the proposed protocol contains a more precise test that allows denial of benefits only with respect to income not derived in connection with the active conduct of a trade or business. (However, this active trade or business test does not apply with respect to a business of making or managing investments, so benefits can be denied with respect to such a business regardless of how actively it is conducted.) The practical difference between the two tests will depend upon how they are interpreted and applied. The principal purpose test may be applied leniently (so that any colorable business purpose suffices to preserve treaty benefits), or it may be applied strictly (so that any significant intent to obtain treaty benefits suffices to deny them). Similarly, the trade or business test could be interpreted to require a more active or a less active trade or business (though the range of interpretation is far narrower). Thus, a narrow reading of the principal purpose test could theoretically be stricter than a broad reading of the active business test (i.e., would operate to deny benefits in potentially abusive situations more often).

In practice, however, the opposite may be more likely. The IRS may find it relatively difficult to sustain a narrow reading of the principal purpose test. In litigation involving Code section 367, for example, which utilized a principal purpose test until 1985, courts have consistently refused to apply this test to transactions where taxpayers could claim any business purpose. Given that possibility, it may well be that the test contained in the proposed protocol will prove stricter than that in the U.S. model treaty.

The proposed protocol also provides an exception that preserves benefits for publicly traded companies. Under this test, a company that is a resident of one of the countries and either (1) in whose principal class of shares there is substantial and regular trading on a recognized securities exchange, or (2) more than 50 percent of whose share of each class is owned by a resident of that country in whose principal class of shares there is also substantial and regular trading on a recognized securities exchange, would be entitled to the benefits of the reduced rates of tax at source on dividends, in-

terest, and royalties regardless of where its actual owners reside. The terms "substantial" and "regular" are not defined in the proposed protocol, nor does the Treasury Department's technical explanation detail any standard for these terms. Presumably then, the terms would be defined pursuant to local law. The regulations under Code section 897, relating to an exception from the taxation of real property income for certain stock that is regularly traded on an established securities market, provide a definition of "regular" for that purpose. Also, the Tax Reform Act of 1986 (the "1986 Act") enacted a branch profits tax that allows certain treaty-protected residents to avoid being subject to the tax if their stock is "primarily and regularly" traded on an established securities market. Although no regulations are prescribed to define the exception from the branch profits tax, it may be that, for practical reasons the definition provided when the regulations are prescribed could be used for interpreting the substantial and regular test under the proposed protocol.

The United States should maintain its policy of limiting treaty shopping opportunities whenever possible. In this regard, it is notable that the proposed protocol would add an anti-treaty shopping provision to the existing treaty. Although drafted to limit foreseeable cases of abuse, the anti-treaty shopping provision of the proposed protocol may not prevent all potential unintended uses of the treaty by third-country investors. For example, it is undestood that the Treasury Department generally does not believe that Belgian Coordination Centers, which are entitled to special tax benefits that result in their paying little or no Belgian tax, can avail themselves of the good business purpose exception. However, to bolster this view, the committee may want to consider an understanding to that effect. Allowing the United States to fully tax U.S. source income derived by a Coordination Center in the event the other conditions to satisfying the anti-treaty shopping provision are not met would be consistent with one of the primary objectives of the existing treaty and the proposed protocol—to eliminate double taxation, rather than all taxation. The committee should further satisfy itself that the anti-treaty shopping provision in its entirety is an adequate deterrent of possible treaty-shopping abuses in the future.

(3) Implementation of the Tax Reform Act of 1986

The 1986 Act enacted several fundamental changes in the U.S. taxation of U.S. persons doing business abroad and foreign persons doing business in the United States. The proposed protocol does not address any of those changes.

One of those changes was the imposition of branch level taxes on foreign corporations earning income effectively connected with the conduct of a U.S. trade or business. The 1986 Act provided that no U.S. treaty shall exempt any foreign corporation from the branch profits tax (or reduce the amount thereof) unless the foreign corporation is a "qualified resident" of the treaty country or the treaty satisfies certain other criteria. (A bill passed by the House of Representatives and pending in the Senate which includes technical corrections to the 1986 Act amends this requirement to provide that only qualified treaty country residents are entitled to treaty waivers or reductions of the branch profits tax.) The 1986 Act also

provided that its withholding tax on dividends paid by a foreign corporation that derives a certain amount of its income from a U.S. business would not apply if the earnings distributed were subject to the branch profits tax.

As indicated above, the proposed protocol does not attempt to implement this change in U.S. tax policy. The proposed protocol does, however, include a provision, which is substantially similar to a provision in the existing treaty, that precludes the United States from imposing its withholding tax on dividends paid by a Belgian company to Belgian residents where the Belgian company derives 25 percent or more of its income does not explicitly provide for the imposition of a branch profits tax.

The issue presented with respect to the branch profits tax (and the other changes in U.S. tax policy caused by the 1986 Act that are not incorporated in the proposed protocol) is whether the proposed protocol should have incorporated this change. On the one hand, the legislative history to the 1986 Act makes it clear that Congress refrained from overriding U.S. income tax treaties that arguably prevented the imposition of the branch profits tax to allow the Treasury Department to renegotiate existing treaties to implement that change in U.S. tax policy. In this case, it would have been appropriate for the proposed protocol to have included this change. On the other hand, the proposed protocol was done quickly to reduce direct investment dividends, but was done on the understanding that a new treaty, which would incorporate, among other things, the many changes brought about by the 1986 Act, would be taken up expeditiously after ratification of the proposed protocol. Since the Treasury Department expects to have a new treaty within twelve months, the Committee could consider the proposed protocol with an understanding, rather than reserving on the issue, that the U.S. tax policy changes in general, and the imposition of the branch profits tax, in particular, caused by the 1986 Act will be incorporated in the new treaty.

III. EXPLANATION OF PROPOSED PROTOCOL

A detailed, article-by-article explanation of the proposed protocol to the income tax treaty between the United States and Belgium is presented below.

Article 1. Dividends

The proposed protocol would replace the present dividend article with a new article whose principal change lowers the maximum allowable rate of tax at source on direct investment dividends. This lower rate is consistent with the rate contained in the U.S. model and recently ratified treaties. The other treaty provisions pertaining to the taxation of dividends are modernized by the proposed protocol, bringing the treaty's dividend article into closer conformity with the U.S. model.

The existing treaty allows both the United States and Belgium to tax dividends paid by a corporation of one country to a resident of the other. The maximum allowable rate of tax at source on dividends is 15 percent, regardless of the recipient's ownership interest in the dividend payor, unless the shares on which the dividends are paid are effectively connected with a permanent establishment in one of the countries. In this latter case, the dividends are taxable as business profits (Article 7 of the treaty). The existing treaty also precludes one country from taxing dividends paid by a corporation of the other country to residents of the other country, unless the shares on which the dividends are paid are effectively connected with a permanent establishment in the first country.

Under the proposed protocol, dividends paid by a corporation of one country to a resident of the other can continue to be taxed by both the United States and Belgium. However, when the corporation paying the dividends is resident in one country and the beneficial owner of the dividends is resident in the other, the maximum allowable rate of tax is 5 percent if the beneficial owner is a company that owns directly at least 10 percent of the voting stock of the corporation paying the dividends. In other cases, the maximum allowable rate continues to be 15 percent. These rules do not restrict the right of a country to tax the profits out of which dividends are paid. This difference in treatment of dividends paid to "direct" investors and to "portfolio" investors (i.e., those company investors not owning at least 10 percent of the payor's voting stock) is consistent with the treatment provided by the U.S. model.

Like the U.S. model treaty, the proposed protocol defines "dividends" as income from shares or other rights which participate in profits and which are not debt claims. To conform with Belgium law, the term also includes income from "jouissance" shares or "jouissance" rights, mining shares, or founders shares which participate in profits and which are not debt claims. Dividends also include income from other corporate rights which is subjected to the

same tax treatment by the country in which the distributing corporation is resident as income from shares. Under this provision, each country may apply its rules for determining when a payment by a resident company is on a debt obligation or an equity interest. Finally, at Belgium's request, the term dividends includes income—even if paid in the form of interest—which is taxable as income from capital invested by the members of a company, other than an incorporated company, which is a resident of Belgium. This latter inclusion in the term dividends, the inclusion of which is substantially similar to a provision in the existing treaty, allows Belgium to exercise an anti-abuse rule in its law by treating as dividends, regardless of how remitted, income paid by an unincorporated Belgian company with respect to capital invested by its owners. The Treasury Department's technical explanation gives as an example of this rule interest paid on loans made to a closely held general partnership by one or more of its partners.

Consistent with the U.S. model and the existing treaty, the proposed protocol's limitations on source country dividend tax will not apply under the proposed protocol if the beneficial owner of the dividend carries on business through a permanent establishment in the source country and the shareholding with respect to which the dividends are paid forms part of the assets of the permanent establishment. The proposed protocol also modernizes the existing treaty by not applying the proposed protocol's limitations on source country dividend tax if the beneficial owner of the dividend performs in the source country independent personal services from a fixed base situated in that country and the shareholding with respect to which the dividends are paid forms part of the assets of the fixed base. In these cases, the dividends are not taxed under the provisions of this article, but as business profits (Article 7 of the treaty) or as independent personal services (Article 14 of the treaty), respectively.

The proposed protocol limits the right of a country to tax dividends paid by a company resident in the other country to residents of that other country. Generally, the country in which the company is not resident may only tax dividends paid by a company resident in the other country to residents of that other country if the shareholding with respect to which the dividends are paid forms part of the assets of a permanent establishment or a fixed base situated in the first mentioned country. However, as indicated in the technical explanation, if the United States is the first mentioned country, it can tax dividends paid by a Belgian company to a U.S. citizen resident in Belgium; the United States reserves the right to tax its citizens as if the convention had not come into effect (paragraph 1 of Article 23).

This provision, which is inconsistent with the U.S. model to the extent it precludes a country from taxing dividends paid to the other country's residents if certain income thresholds are met by the distributing company, precludes the United States from imposing its withholding tax on dividends paid to Belgian residents by a Belgian company that derives 25 percent or more of its income from a U.S. business.

As under the existing treaty, the proposed protocol allows Belgium to tax, pursuant to its internal law, dividends paid by a com-

pany which is a resident of Belgium to a company not resident in Belgium but where the shareholding forms part of the assets of a permanent establishment situated in Belgium.

Article 2. Cross Reference

This article merely corrects a cross-reference in the existing treaty caused by the proposed protocol.

Article 3. Limitation on Benefits

The proposed protocol contains a provision which is intended to limit the benefits of the reduced rates of tax at source on dividends, interest, and royalties to persons who are entitled to those benefits by reason of their residence in the United States or Belgium. The present treaty does not contain such a provision. The new provision is somewhat less strict than the corresponding provision of the U.S. model treaty. It is similar to, but not identical to, the limitation of benefits articles included in the recently ratified U.S. income tax treaties with Barbados, Australia, and New Zealand.

The treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Belgium as they apply to residents of the two countries. At times, however, residents of third countries attempt to use a treaty. Such use is known as "treaty shopping," and refers to the situation where a person who is not a resident of either country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, and without appropriate safeguards, the nonresident is able indirectly to secure these benefits by establishing a corporation (or other entity) in one of the countries which, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for the third country resident to reduce the income base of the treaty country resident by having the latter pay out interest, royalties, or other amounts under favorable conditions (i.e., it may be possible to reduce or eliminate the taxes of the resident company by distributing its earnings through deductible payments or by avoiding withholding taxes on the distributions) either through relaxed tax provisions in the resident country or by passing the funds through other treaty countries (essentially, continuing to treaty shop), until the funds can be repatriated under favorable terms.

As indicated above, the proposed new anti-treaty shopping article of the protocol is intended to limit the benefits of the reduced rates of tax at source on dividends, interest, and royalties to bona fide residents of the two countries. This would be accomplished by providing that a person other than an individual (such as a corporation, partnership or trust) is not entitled to the benefits of the reduced rates of tax at source on dividends, interest, and royalties unless it satisfies any one of an ownership and "base erosion" test, a good business purpose test, or a public company test.

Under the ownership and base erosion test two conditions must be satisfied. First, more than 50 percent of the beneficial interest in the person (in the case of a company, more than 50 percent of the number of shares of each class of shares) must be owned directly or indirectly by any combination of one or more individual resi-

dents of Belgium or the United States, citizens of the United States, or the governments of the United States or Belgium. This provision would, for example, deny the benefits of the reduced U.S. withholding tax rates on dividends, interest, or royalties paid to a Belgium company that is controlled by individual residents of a third country. This rule is not as strict as that contained in the U.S. model, which requires 75 percent ownership, by residents of the person's country of residence, to preserve benefits.

Second, reduced rates of tax at source on dividends, interest, and royalties is available only if more than 50 percent of the gross income of the person is not used directly or indirectly to meet liabilities for interest or royalties to persons who are not residents of Belgium or the United States, citizens of the United States, or the governments of Belgium or the United States. This rule is commonly referred to as the "base erosion" rule and is necessary to prevent a corporation, for example, from distributing most of its income through the use of deductible payments to persons not entitled to benefits under the treaty. Gross income for this purpose is defined to mean: in the case of the United States, gross income as defined in the Internal Revenue Code of 1986, as may be amended from time to time, without regard to the geographic source of the income; and in the case of Belgium, gross receipts, or in the case of a manufacturer or producer of goods, gross receipts reduced by the direct costs of labor and materials attributable to the manufacture or production and paid or payable out of those receipts. This provision is substantially similar to that in the U.S. model treaty.

Under the good business purpose test, denial of reduced rates of tax at source would not occur if the resident entity's dividends, interest, or royalties are derived in connnection with, or are incidental to, the active conduct of a trade or business in the residence country. However, this exception does not apply (and benefits are therefore denied) to a business the principal activities of which are making or managing investments in the source country. This active trade or business rule replaces a more general rule in the U.S. model treaty and most recent U.S. income tax treaties that preserves benefits if an entity is not used "for a principal purpose of obtaining benefits" under a treaty. It is understood that a Belgian Coordination Center, which receives special tax benefits in Belgium, generally cannot avail itself of the good business purpose test. This would result in, for example, a Belgian Coordination Center, which does not satisfy the ownership or base erosion tests and which receives dividends, interest, or royalties from the United States, not being entitled to reduced rates of U.S. tax under the treaty (unless it satisfied the public company test).

Under the public company test, a company that is a resident of one of the countries and either (1) in whose principal class of shares there is substantial and regular trading on a recognized securities exchange, or (2) more than 50 percent of whose shares of each class is owned by a resident of that country in whose principal class of shares there is also substantial and regular trading on a recognized securities exchange, would be entitled to the benefits of the reduced rates of tax at source on dividends, interest, and royalties regardless of where its actual owners reside. The term "recognized securities exchange" means any stock exchange registered

with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934, the NASDAQ system owned by the National Association of Securities Dealers, Inc., the Belgium stock exchanges, and any other securities exchange agreed upon by the competent authorities of the two countries.

Article 4. Entry into Force

The proposed protocol will enter into force on the fifteenth day after the date of the exchange of the instruments of ratification. Once in force, the provisions of the proposed protocol will apply retroactively to dividends, interest, and royalties credited or paid on or after January 1, 1988.

Article 5. Termination

The proposed protocol will remain in force as long as the U.S.-Belgium income tax treaty remains in force.

A separate termination provision provides, however, that either country can terminate separately the provisions of the proposed protocol by giving through diplomatic channels at least six months' written notice of termination to the other country at any time after five years from the day on which the proposed protocol enters into force. In this case, the proposed protocol ceases to apply to dividends, interest, and royalties credited or paid on or after the first January 1 that follows after expiration of the six-month period and the provisions of the treaty, as effective on December 31, 1987, shall apply to those amounts.

Exchange of Notes

At the signing of the proposed protocol, notes were exchanged confirming the understanding of the U.S. and Belgium delegations as to the meaning of "beneficial interest", as that term is used in the anti-treaty shopping article As indicated above, the proposed protocol would add an anti-treaty shopping article. Unless other conditions are satisfied, the proposed protocol would preclude a person (other than an individual) from claiming reduced rates of tax at source on dividends, interest, and royalties unless more than 50 percent of the "beneficial interest" in the person is owned directly or indirectly by any combination of one or more individual residents of Belgium or the United States, citizens of the United States, or the governments of Belgium or the United States. The Belgium and United States delegations agreed that the French and Dutch language texts of the anti-treaty shopping article would incorporate the English meaning of the term "beneficial interest." As intended, more than 50 percent of the rights to income and other economic rights in the person claiming treaty benefits would have to be owned by qualifying persons. As an example, the notes stated that in the case of a trust claiming treaty benefits, more than 50 percent of the interests held by beneficiaries of the trust must be held by qualifying persons. The identities of the legal owners of the trust would be irrelevant for this purpose, the notes stated.